

Internal Revenue Service
memorandum

CC:TL:TS

JLRICKS

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to: Matthew A. Lykken CC:DAL
Project Attorney
District Counsel, Dallas

from: Chief, Tax Shelter Branch CC:TL:TS

subject: Use of Form 870 or Form 870-AD Consents Versus a Specific Matters
Closing Agreement (Form 906) in Settlement Initiative Cases

This is in reply to your memorandum of November 12, 1987, requesting technical advice concerning the use of Form 870 or Form 870-AD consents versus specific matters closing agreements (Form 906) in settlement initiative cases.

ISSUES:

1. Whether it is permissible to use Form 870 or Form 870-AD consents rather than specific matters closing agreements (Form 906) in settlement initiative cases where the closing agreements involve pre-TEFRA years, but also include determinations which resolve some, but not all, partnership issues for the TEFRA years?
2. What effect do specific matters closing agreements for pre-TEFRA years, which include determinations which impact TEFRA years, have on the treatment of partnership items in the TEFRA years?

CONCLUSIONS

1. Form 870 or Form 870-AD consents should not be used to settle pre-TEFRA years when the Service includes determinations which resolve some partnership issues for TEFRA years.
2. This is an open question which the regulations do not address and the National Office has not yet resolved.

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FACTS

Settlement agreements are being drafted in a tax shelter settlement initiative project. The project involves both pre-TEFRA and TEFRA years. The shelter is composed of real estate partnerships, which are being settled on the basis of complex computations. In some cases, the computations include flow-through losses from other entities. The draft closing agreements generally state the overall partnership income or loss for the pre-TEFRA years. These draft closing agreements also include determinations, such as the partnership is not entitled to use the Rule of 78's.

DISCUSSION

ISSUE #1

The Service takes the position that specific matters closing agreements should be used in cases where the Service wishes to bind the taxpayer to tax liabilities for pre-TEFRA years and to make specific determinations which will bind the taxpayer for the TEFRA years. Unlike Form 870 and Form 870-AD, the specific matters closing agreement (Form 906) can bind the taxpayer in subsequent years. Treas. Reg. § 601.202(a)(2). In addition, since closing agreements are the only statutorily authorized method for entering into an agreement binding on both the Service and the taxpayer, I.R.C. § 7121, they have a greater binding effect on the taxpayer than a Form 870 or Form 870-AD.

On the other hand, Form 870-AD only binds the taxpayer to the bottom-line amount of the deficiency for each taxable year stated in the agreement, other than for amounts attributable to carrybacks provided by law. Thus, the taxpayer is not bound to determinations made which may affect subsequent TEFRA years.

Moreover, a Form 870-AD does not have the degree of finality afforded Form 906 closing agreements. We note that the Ninth Circuit held that the taxpayer's execution of a Form 870-AD does not in itself preclude the taxpayer from filing a claim for refund. Whitney v. United States, 826 F.2d 896 (9th Cir. 1987). While we prefer the use of Form 906 in all shelter initiative cases, we have approved the use of Form 870-AD for cases involving one year where no adjustments to subsequent years (which would require a closing agreement) are made.

Likewise, Form 870 would not bind a taxpayer to determinations made which would affect TEFRA years. A Form 870 allows the taxpayer to challenge the deficiency determination for the years in issue. Form 870 allows the taxpayer to file a claim for refund, and if denied by the Service, to file a refund suit in district court or in the United States Claims Court. Form 870 only precludes the taxpayer from filing a petition in the United States Tax Court. For these reasons, the Tax Shelter Settlement Initiative guidelines do not authorize the use of Form 870 consents when settling tax shelter initiative cases.

We note that a specific matters closing agreement is not meant to be used as a comprehensive closing agreement. It is meant to be used in situations in which an agreement has been reached concerning the disposition of one or more issues and the Service wishes to insure the consistent treatment of such issues in other tax years. Treas. Reg. § 601.202(b). Further, in drafting any closing agreement, the issues resolved should be stated as specifically as possible.

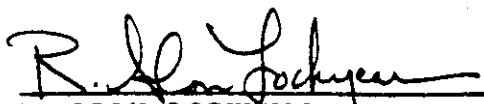
ISSUE #2

Section 6624(a) provides that "any partner has the right to participate in any administrative proceeding relating to the determination of partnership items at the partnership level." Partnership items of a partner for a partnership taxable year become nonpartnership items on the date that the Service enters into a settlement agreement with the partner. I.R.C. § 6231(b)(1)(C). Thus, a partner relinquishes his right to participate in any administrative proceeding if he enters into a settlement agreement. Temp. Treas. Reg. § 301.6224(c)-3T provides that a settlement agreement must be comprehensive, and cannot be limited to selected items.

If the taxpayer executes a specific matters closing agreement which binds all partnership items for the TEFRA years, he has executed a "settlement agreement" with regard to the TEFRA years. However, a specific matters closing agreement, which binds some (but not all) partnership items for the TEFRA years, is not a comprehensive settlement agreement for the TEFRA years. The National Office has not determined the procedural effect that this type of "partial" settlement agreement would have on the treatment of those resolved partnership items (or other unresolved partnership items) in the TEFRA years.

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